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IN THE

Supreme Court of the United States

October Term, 1955

No. 924

A proceeding for reorganization under Chapter 10 of the Bankruptcy Act.

No. 90460

In the Matter

of

HUDSON & MANHATTAN RAILROAD COMPANY,

Debtor, Petitioner.

WILLIAM J. HARDING, JR., IRVING I. SCHNUR AND SHIRLEY REITER,

Petitioning-Creditors, Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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—against—

WILLIAM J. HARDING, JR., IRVING I. SCHNUR and SHIRLEY REITER,

Petitioning-Creditors, Respondents.

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Hudson and Manhattan Railroad Company, your petitioner, by its attorneys Valente & Hallheimer, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above entitled case on February 9, 1956, affirming two orders of the District Court of the United States for the Southern District of New York, *viz.*: Order No. 28, denying the debtor's application for leave to obtain and present proof on a trial in support of its denials

of the jurisdictional allegations of the creditors' petition for involuntary reorganization; and Order No. 36, denying leave to the debtor to withdraw its consent to reorganization and to answer *de novo* so as to require a trial of the jurisdictional issues.

Opinions Below

The opinion of the Court of Appeals (App. A, *infra*, pp. 33-42) is reported in 229 Fed. 2nd 616. The opinion of the District Court, Southern District of New York, has not been reported, but appears in the Appendix of the Trustee of the Debtor (Tr. App., pp. 265-266).

Jurisdiction

The judgment of the Court of Appeals was entered February 9, 1956 (*infra*, App. B, p. 43). The jurisdiction of this Court is invoked under Sec. 24 (c) of the Bankruptcy Act [11 U. S. C. 47 (c)].

Questions Presented

1. Whether the judicial power of the United States extends to the involuntary reorganization of a solvent railroad corporation when, in the absence of a showing of federal jurisdiction in the record, the District Court and the Court of Appeals have both failed and *refused* to take proof of the actual existence of the facts upon which federal jurisdiction depends in the face of a direct challenge to the jurisdiction of the Court over the subject matter of the proceeding.

2. Whether it is competent for a Federal Court to dispense with the allegation and proof of the act of bankruptcy required by Sec. 131 (5)[1] of all creditors petitioning for involuntary corporate reorganization under Chapter X; and, by making an order approving the petition, to foreclose, under Sec. 149,[2] a challenge to the jurisdiction of the court over the subject matter and to the power of the judge to make the order.

3. Whether a debtor is entitled to amend its answer within 20 days as a matter of absolute right under Rule 15(a) F. R. C. P., in an involuntary reorganization proceeding under Chapter X.

Statutes and Regulations Involved

The following statutes and regulations involved in this case are set out verbatim in Appendix C, *infra*, pp. 45-48.

Bankruptcy Act §§24, 30, 130, 131, 136, 142, 143, 149;
General Orders in Bankruptcy, No. 37;
Federal Rules of Civil Procedure, Rules 15(a), 12(h).

Statement of the Case

The appellant is a solvent (by over fifty million dollars) common carrier by railroad engaged in the transportation of passengers in interstate commerce.

On August 11, 1954, three of its bondholders filed in the District Court of the United States for the Southern District of New York a creditors' petition for involuntary

[1] Subdivisions (1), (2), (3) and 4 of § 131 do not apply.
[2] All section references are to the Bankruptcy Act.

reorganization under Chapter X of the Bankruptcy Act, alleging that the railroad is *not* part of a general railroad system of transportation, that it is insolvent and that it had within four months prior thereto committed acts of bankruptcy by making various preferential payments while insolvent (Ap. 9-15).[3]

On September 24, 1954, the debtor moved on affidavits to dismiss the petition on the ground that the Court had no jurisdiction under Chapter X to reorganize a railroad that *was* operated as part of a general railroad system of transportation.

An order had in the meantime been entered on August 20, 1954 continuing the debtor in possession of its property and authorizing the debtor to operate its business and, among other things, to pay taxes accrued "since the filing of the petition" (Ap. 17).

The debtor's Board of Directors, advised by its counsel that the New York City real estate taxes for a period *prior* to the filing of the petition could not be paid under the order of the Court dated August 20, 1954 applied to the Court for authority to pay such taxes falling due October 1, 1954. The Court denied the motion (Tr. 712-723). Thereupon Hanover Bank, the Indenture Trustee, on November 4, 1954 declared the failure to pay such taxes a default under the mortgage indenture, and declared the total indebtedness to be then due (Tr. 328).

Impelled by the refusal of the Court to authorize payment of the taxes and the declaration of a default by

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[3] References to the record below are as follows: Ap. refers to Debtor-Appellant's Appendix; Tr. refers to the transcript of record and Tr. Ap. refers to the appendix of the Trustee of the Debtor.

Hanover (Tr. 331), and while its motion to dismiss the creditors' petition was still pending undetermined, the debtor filed with the Interstate Commerce Commission and with the District Court a voluntary petition under Chapter VIII, Section 77 for the reorganization of railroad corporations, alleging among other things a funded debt of $67,146,000 due February 7, 1957; that it was unable to meet its debts as they mature, and praying for reorganization under Section 77.

The debtor's voluntary petition was referred to the same judge who had the creditors' petition under consideration and he thereupon granted to the petitioning creditors an order to show cause, dated November 23, 1954, returnable at 4 P.M. the same day, why a receiver of the debtor and its property should not be appointed and why the debtor should not be restrained from proceeding under Chapter VIII (Tr. 723A). On November 24, 1954 the Court made an order appointing William Golub, Esq. (now one of the Trustee's counsel), the receiver of the debtor and its property under Chapter X (Tr. 724).

Two days later the debtor filed a notice of appeal therefrom and also separately appealed from the order denying permission to pay the New York City real estate taxes (Tr. 729-730).

Four days later on December 1, 1954 the district judge denied the debtor's motion to dismiss the creditors' petition and denied also the debtor's application for approval of its voluntary petition under Chapter VIII (Tr. 731-741) holding that Chapter X and not Chapter VIII was applicable to the debtor's reorganization.

On December 2, 1954 the debtor's Board of Directors deadlocked over whether to appeal from the order refusing to dismiss the Chapter X petition for want of jurisdiction or whether to withdraw the two pending appeals and permit the reorganization of the company in the Chapter X proceeding.

The deadlock was broken by the deciding vote cast by Mr. William Reid, Chairman of the Board. Thereupon a 4 to 3 resolution was adopted instructing debtor's counsel to withdraw the appeal and "file such papers as may be necessary to permit reorganization under Chapter X" (Ap. 106). A copy of the resolution together with instructions to consent to the approval of the creditors' petition was on the same day delivered to debtor's counsel (Ap. 106, 107).

Four days after receipt of these instructions and on December 6, 1954, its counsel nevertheless advised the debtor not to consent to approval of the petition and to file instead, a formal answer denying the acts of bankruptcy alleged in the creditors' petition, but joining in so much only of the petition as prayed for reorganization.

This advice of counsel was in writing (Ex. 5, Ap. 108), and cautioned the debtor that (a) an order approving the petition cannot be made without the taking of proof when an issue is raised as to any material allegation of the petition; (b) the allegations in the creditors' petition that the debtor had committed acts of bankruptcy consisting of making preferential payments while insolvent, were necessary and material allegations in a creditors' petition; (c) the denial of those allegations of the petition would raise an issue which would require the taking of proof;

(d) counsel therefore would not forecast approval of the creditors' petition upon the basis of a consent to reorganization contained in an answer that denies the acts of bankruptcy and finally (e) the debtor should instruct counsel, in the light of this advice, whether to file a naked consent or raise an issue requiring the taking of proof as recommended by counsel.

On the same day the debtor, in a letter delivered by hand unanimously accepted counsel's recommendation and directed the filing of an answer raising the issue (Ex. 6, Ap. 112).

Two days later, on December 8, 1954, the debtor withdrew its two pending appeals and filed its "Answer and consent to reorganization" which states:

> "the Court having held that Chapter X and not Section 77 is the statute applicable to the debtor's reorganization, the debtor therefore, without conceding the applicability of Chapter X answers the creditors' petition as follows"

and then *denies the jurisdictional allegations* of the petition that the debtor had committed acts of bankruptcy while insolvent, *denies specifically* that it made the preferential transfers alleged, admits inability to pay its debts as they mature, and joins in so much of the petition as prays for reorganization.

On December 14, 1954, the judge approved the creditors' petition "due to and by reason of the debtor's answer and consent to reorganization" (Ap. 20).

On December 22, 1954, Kyriacos Dimitriou, a stockholder, filed an answer denying the material allegations of the petition (Ap. 21).

On December 28, 1954, the debtor served its amended answer which "without conceding the applicability of Chapter X" *denied the jurisdictional allegation* of the petition that its railroad is not operated as part of a general railroad system of transportation, *specifically denied* that the debtor is insolvent, *specifically denied* that it had committed the various acts of bankruptcy alleged, *denied* the creditors' petition was filed in good faith, and, admitting its inability to pay its debts as they mature, joined in the prayer for reorganization (Ap. 23-24).

On February 23, 1955 the judge held a pre-trial conference on the issues raised by the pleadings at which the debtor applied by written motion on notice for authority to employ Coverdale & Colpitts, consulting engineers, as its experts to procure and give evidence upon the forthcoming trial of the issues in support of the debtor's denials that it was insolvent and had committed acts of bankruptcy (Ap. 25-35). The debtor insisted that the taking of proof was a *jurisdictional* requirement (Tr. Ap. 16), (App. A, p. 39, *infra*).

Upon the hearing the judge nevertheless held that despite the denials and by reason of the debtor's consent to reorganization:

(a) The proceedings are the same as though the debtor had filed a voluntary petition for reorganization under Chapter X (Ap. 46);

(b) That the debtor is not an adversary in the proceeding (Ap. 50) and is "clearly out of this" (Ap. 53);

(c) That, as a matter of law "insolvency is not an issue material to this proceeding so far as the debtor is concerned" (Ap. 52);

(d) That even if the issue of solvency were material, it can't be raised by the debtor (Ap. 53);

(e) That there is no issue between the petitioning creditors and the debtor (Ap. 53);

(f) That the limitation of issues by the judge on the pre-trial conference constitutes a denial of the debtor's motion (Ap. 52-53).

From the order (No. 28) denying the debtor's application, the debtor appealed to the Court of Appeals.

On March 3, 1955, the debtor accordingly brought on by petition and order to show cause, a formal motion for leave to withdraw its amended answer and consent to reorganization, and for leave to answer *de novo,* on the ground that the construction placed upon such consent by the Court was unexpected and unintended by the debtor, in that the debtor intended by its denials to controvert the material and jurisdictional allegations of the petition and to litigate the issues thereby raised by proof on a trial (Ap. 36-44).

On the hearing of the motion the judge permitted issue to be orally joined in open court (Ap. 61)[4] and directed the debtor to then and there proceed to a *trial of the motion* for leave to amend the pleading, over protest of debtor's counsel that he had come to court prepared only to argue a motion and had neither witnesses nor documents in court (Ap. 68, 69).

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[4] The Court: All right. I tell you, Mr. Garlock, what we will do. If you will specify your denials, I won't hold you to any admissions in view of the fact that you are called upon to do this extemporaneously. So you go ahead and those things you are clear on that you are going to deny, you tell us.

The debtor offered proof by the testimony of Mr. Reid, the Chairman of the Board, who had in the meantime been summoned by telephone at the direction of the Court, that the debtor *intended to litigate* the jurisdictional issues raised by its denials of the material allegations of the creditors' petition (Ap. 69, 76, 80-82).

The judge excluded the debtor's proof of its *intent to litigate* the issues raised (Ap. 80-82), and denied the motion on the ground that the debtor *never intended to litigate* the issues prior to final approval of the petition and that the debtor's motion was therefore brought in bad faith (Ap. 4, 7, 8). From the order (No. 36) denying this motion the debtor likewise appealed to the Court of Appeals.

Proceedings in Court of Appeals. The jurisdictional issue was squarely raised in the Court of Appeals. A separate point was raised as follows:

> "This court has a duty to inquire into the jurisdiction of the district court. The question of federal jurisdiction is raised on this appeal."

The Court of Appeals, however, as was the case with the district court, *assumed* the existence of the jurisdictional facts which would give the district judge power to approve the creditors' petition, and upon that assumption held that:

> "§149 of Chapter X, 11 U. S. C. A. §549 made the court's order of December 14 approving the petition conclusive against the debtor. Section 149 provides: 'an order, which has become final, approving a petition filed under this chapter shall be a conclu-

sive adjudication of the jurisdiction of the Court' " (App. A, *infra*, p. 39).

The court below further held that despite the provisions of Rule 15(a) of the Federal Rules of Civil Procedure allowing amendment of pleadings within 20 days as a matter of course, the debtor's amended answer, timely served within 20 days was nevertheless a nullity because it was served without leave of the court after the judge had already made an order approving the petition on the basis of the debtor's original answer (App. A, p. 38, *infra*).

The court below said that the debtor's denials of the jurisdictional allegations of the petition raised no issues because of the consent to reorganization (App. A, pp. 36, 39, *infra*).

As the case now stands no proof has ever been taken of the existence of the jurisdictional facts required by §131 to be shown in a proceeding for involuntary reorganization and federal jurisdiction of the subject matter has never been determined although directly challenged.

Statement Pursuant to Rule 23, subd. 1(g) of the Supreme Court Rules

There is not now and there never has been a basis for federal jurisdiction in the court of first instance. The District Court, with the approval of the Court of Appeals, is nevertheless proceeding with the debtor's reorganization on the merits.

Reasons for Granting the Writ

Federal jurisdiction must affirmatively appear in the record. Without proof in the record to sustain the controverted jurisdictional allegations of the creditors' petition (that the debtor is insolvent; that it committed acts of bankruptcy and that its railroad is not operated as part of a general railroad system of transportation) the acts of the district court and the Court of Appeals are *coram non judice.*

I. The first duty of this Court is to inquire into the jurisdiction of the courts from whence the record comes, and to then deny the existence of federal jurisdiction if it does not affirmatively appear in the record.

The duty of a court, both trial and appellate, in determining jurisdiction is concisely stated by Professors Hart and Wechsler (*The Federal Courts and the Federal System*):

> "The first duty of counsel is to make clear to the court the basis of its jurisdiction as a federal court. The first duty of the court is to make sure that jurisdiction exists. If the record fails to disclose a basis for federal jurisdiction, the courts not only will but must refuse to proceed further with the determination of the merits of the controversy unless the failure can be cured. This is true whether the case is at the trial stage or the appellate stage, and whether the defect is called to the court's attention 'by suggestion of the parties or otherwise' " (Id. at 719).

All presumptions are against the jurisdiction of a United States District Court. The question of jurisdiction, whether or not raised by the parties, is always, during the progress of the case, before the federal courts, both trial and appellate. (Dobie on Federal Procedure, Section 16, page 25.)

> "The question of federal jurisdiction is ever present and *self asserting.* The Court must of its own motion and even against the consent or the protest of the parties consider it." (*Schell* v. *Food Machinery Corp.*, 5 Cir., 87 F. 2nd, 385, 387.) (Italics added.)

This Court has said the rule is inflexible. In *Mansfield, Coldwater & Lake Michigan Ry.* v. *Swan,* 111 U. S. 379, this Court declared:

> " • • • the rule, springing from the nature and limits of the judicial power of the United States, is inflexible and without exception which requires this court, of its own motion, to deny its own jurisdiction, and, in the exercise of its appellate power, that of all other courts of the United States, in all cases where such jurisdiction does not affirmatively appear in the record on which, in the exercise of that power, it is called to act. On every writ of error or appeal the first and fundamental question is that of jurisdiction, first of this court, and then of the court from which the record comes. *This question the court is bound to ask and answer for itself,* even when not otherwise suggested, and without respect to the relation of the parties to it." (Emphasis supplied.)

There can be no doubt that the district court has judicial power to hear and determine the question of its own juris-

diction, both as to parties and as to subject matter (In *Re R. H. Development Co.*, 62 F. Supp. 722 [N. D. Cal., 1945]). Such a determination neither binds nor precludes an inquiry by an appellate court. The danger inherent in permitting a court to pull itself up by its own "bootstraps" requires every appellate court to consider carefully whether or not the jurisdictional requirements have been met.

Sections 130, 131 and 143 Are Jurisdictional

The power of the Court to act at all in reorganization proceedings derives only from the Bankruptcy Act.

The jurisdictional requirements which must be met in a Chapter X proceeding are set forth in Sections 130, 131 and 143 of the Bankruptcy Act. (11 U. S. C. §§530, 531, 543.)

> "A necessary jurisdictional averment prescribed by the statute is that the debtor has committed an *act of bankruptcy* within four months, unless a prior proceeding in bankruptcy or equity receivership is pending and is avered as pending. It follows that the petition is fatally defective in failing to aver that the debtor has committed an act of bankruptcy within four months." (*In re Central Public Utility Corporation*, 9. F. Supp. 17 [Del., 1934]). (Italics added.)[5]

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[5] "One of the necessary *jurisdictional* allegations in a proceeding of this character is that the corporation against whom the proceeding is aimed has committed an act of bankruptcy within four months (see section 77B(a))." In re Rialto Properties Co., 8 F. Supp. 57, 58 (N. D. Cal., 1934). " * * * the act of bankruptcy, *to form the basis for jurisdiction*, must have been committed within four months previous to the filing of the petition, under section 77B(a)." (Id. at 59) (now Section 131) (Italics added).

Former Section 77B(a) required creditors to allege that the corporation is insolvent or unable to meet its debts as they mature *and* that it committed an act of bankruptcy within four months. These same allegations are now required by separate sections of the Act, namely 130 and 131.

Section 130 governs *all* petitions, as follows:

> "Sec. 130. Every petition shall state—
> (1) That the corporation is insolvent or unable to pay its debts as they mature."
> * * *

Section 131 governs *creditors* petitions and requires something more than is required of every other petition; *viz.*:

> "Sec. 131. A creditors' * * * petition shall, in addition to the allegations required by section 130 of this Act, state (1) * * * (2) * * * (3) * * * (4) * * * (5) that the corporation has committed an act of bankruptcy within four months prior to the filing of the petition."

These are material allegations; without them a creditor's petition cannot be made and the power of the court to act upon the petition is dependent upon their averment (*Re Central Public Utility Corp., supra; re Rialto Properties Co., supra*).

When such an allegation is controverted, Section 143 at once becomes operative.

> "Sec. 143. If the answer of a debtor shall controvert *any* of the material allegations of the petition, the judge shall as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied * * * that the material

> allegations are sustained by the *proofs*, or dismissing it if not so satisfied." (Italics added.)

Section 143 is mandatory and imperative, leaving no element of discretion. The jurisdictional allegations must now be proved, and the clear command of the statute is that the judge must dismiss the petition unless the creditors sustain the controverted allegations with proof. The jurisdiction of the court hinges upon that proof.

In our case these material allegations are controverted by the debtor's *specific* denials. The debtor insisted on trying the issues. The district judge refused, and was sustained by the Court of Appeals. The question remains whether proof was required to be taken.

That question has been explicitly and comprehensively answered by this Court in *McNutt* v. *General Motors Acceptance Corp.*, 298 U. S. 178, in an exposition of the ever present duty of a federal court to dismiss a civil action or proceeding in the absence of affirmative proof in the record of the facts on which jurisdiction depends.

This Court there decided the question which had been intentionally left undecided by it in *Chase* v. *Wetzlar*, 225 U. S. 79, regarding the fatal obligation of the party seeking the exercise of federal jurisdiction to prove facts essential to show jurisdiction. "The question which was thus suggested and put aside in *Chase* v. *Wetzlar* is definitely before us in the instant case and should be decided."

Chief Justice Hughes, writing the Court's opinion in the *McNutt* case said (298 U. S. 178 at p. 189):

> "The prerequisites to the exercise of jurisdiction are specifically defined and the plain import of the

statute[6] is that the District Court is vested with authority to inquire at any time whether these conditions have been met. They are conditions which must be met by the party who seeks the exercise of jurisdiction in his favor. He must allege in his pleading the facts essential to show jurisdiction. If he fails to make the necessary allegations he has no standing. If he does make them, an inquiry into the existence of jurisdiction is obviously for the purpose of determining whether the facts support his allegations. In the nature of things, the authorized inquiry is primarily directed to the one who claims that the power of the court should be exerted in his behalf. As he is seeking relief subject to this supervision, it follows that he must carry throughout the litigation the burden of showing that he is properly in court. The authority which the statute vests in the court to enforce the limitations of its jurisdiction *precludes the idea that jurisdiction may be maintained by mere averment or that the party asserting jurisdiction may be relieved of his burden by any formal procedure. If his allegations of jurisdictional facts are challenged by his adversary in any appropriate manner, he must support them by competent proof.* And where they are not so challenged the court may still insist that the jurisdictional facts be established or the case be dismissed, and for that purpose the court may demand that the party alleging jurisdiction justify his allegations by a preponderance of evidence. We think that only in this way may the practice of the District Courts

[6] Act of March 3, 1875 requiring a Federal Court of its own motion to dismiss a pending suit when it is found not to be really within its jurisdiction. [This section later became: Jud. Code 1911, §37; former 28 U. S. C. 80, now F. R. C. P. Rule 12(h). "This rule continues U. S. C. A. Title 28, former §80 (Dismissal or remand) (of action over which district court lacks jurisdiction) * * *". Notes of Advisory Committee as to Rule 12(h)].

be harmonized with the true intent of the statute which clothes them with adequate authority *and imposes upon them a correlative duty.*

Here, the allegation in the bill of complaint as to jurisdictional amount was traversed by the answer. *The court made no adequate finding upon that issue of fact, and the record contains no evidence to support the allegation of the bill. There was thus no showing that the District Court had jurisdiction* and the bill should have been dismissed upon that ground." (Italics supplied.)

Diametrically opposed is the decision below where the Court said:

"• • • the filing of such an answer makes it unnecessary to allege or prove any of the acts required by §131, 11 U. S. C. A. §531" (App. A, *infra*, p. 37).

This, perforce, leaves the record without evidence to support the petition, and, just as in *McNutt's* case, without any finding upon the issue raised by the specific denials of the jurisdictional facts alleged in the petition. "There is thus no showing that the district court had jurisdiction" (*McNutt* v. *General Motors, supra*), and this:

"• • • requires this court, of its own motion, to deny its own jurisdiction, and in the exercise of its appellate power, that of all other courts of the United States, in all cases where such jurisdiction does not affirmatively appear in the record • • •" (*Mansfield, Goldwater etc.* v. *Swan, supra*).

The Decision Below Is in Conflict With the Decision of the Court of Appeals in the Seventh Circuit and With the Applicable Decisions of the Supreme Court.

The courts below have said that the debtor's consent to reorganization was sufficient to meet the jurisdictional requirements of the statute. They seemed to think the denials were nullified by the consent but it can be said with equal force that the consent was nullified by the denials. They nevertheless reasoned that by virtue of the consent, the denials had no thrust, and hence no material allegations were controverted, wherefore, the need to take proof no longer existed (§142). Thus, the Court below, after quoting §142, said in that regard:

> "The answer filed by the debtor on December 8 empowered the Court under this section to approve the petition without a hearing and to appoint a trustee. The debtor's consent to reorganization and admission of inability to pay debts made the controverted allegations relating to acts of bankruptcy immaterial.
>
> • • •
>
> "Judge Walsh was therefore correct in treating the pleading as if the answer had not controverted any material allegation of the petition and finding that the petition 'by reason of the Debtor's answer and consent to reorganization' complied with the requirements of Chapter X" (App. A, *infra*, pp. 36, 38).

It is thus plain that the Court below has now gainsaid as "immaterial" the act of bankruptcy which the Congress has expressly declared to be indispensible. This would seem to constitute judicial legislation.

But the compelling fact is that jurisdiction of the *res* thereby stands founded upon consent.

> "In a discussion of the question it is appropriate that sight be not lost of certain considerations, viz.:
>
> (a) That jurisdiction cannot be conferred upon a federal court by consent, for its jurisdiction springs wholly from the Constitution and statutes of the United States;" [*Barkman* v. *Sanford*, 162 F. 2d 592, 593, cert. denied 332 U. S. 816 (1947)].

Section 142 permits approval of the petition if "the answer filed does not controvert * * * ". But the answer filed by the debtor *does* controvert.[7]

Consequently, the requisite facts on which jurisdiction under a creditor's petition depends under §131 are nowhere admitted. They are denied. Apart from the consent to reorganization, the debtor admits no facts from which the court could say as a matter of law that jurisdiction exists under the creditors' petition.

> "* * * Plaintiff's argument is predicated upon the premise that the defendant 'specifically admitted the

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[7] "2. Denies each and every act of bankruptcy and/or mismanagement therein alleged, and denies *specifically* that any of the payments therein alleged to be preferential were preferential or were made with the intent to prefer the unsecured creditor who received it over the debtor's other secured and unsecured creditors" (Ap. 19). (Italics added.)

And in the amended answer (Ap. 24):

"2. Denies each and every act of bankruptcy and/or mismanagement therein alleged, and denies *specifically* (1) that the debtor is insolvent and (2) that any of the payments therein alleged to be preferential were preferential or were made with the intent to prefer the unsecured creditor who received it over the debtor's other secured and unsecured creditors.

3. Denies the allegations of the petition contained in paragraphs thereof marked 3(a), 7, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21 and 24." (Italics added.)

> jurisdictional allegations of the complaint.' This is an overstatement of defendant's admission. • • • Defendant's admission was that the court had jurisdiction. *Nothing was admitted regarding the factual allegations of the complaint upon which jurisdiction was claimed.* In other words, the defendant admitted no facts from which the court could say, as a matter of law, that jurisdiction existed. *Defendant's answer amounted to nothing more than consent on his part that jurisdiction be taken. As we shall later point out, jurisdiction cannot be conferred in this manner''* (*Page* v. *Wright,* 116 F. 2d 449, 451, 7th Cir., 1940). (Italics added.)

Page v. *Wright,* decided in 1940 by the Court of Appeals for the Seventh Circuit, stands irreconcilably in conflict with the decision rendered herein by the Court of Appeals for the Second Circuit. The question before the respective courts was identical although it arose from a different set of circumstances.

In the *Page* case, the Court restricted its consideration to one of the questions raised: "want of jurisdiction". Jurisdiction was allegedly based on diversity of citizenship. A motion for summary judgment had been made and argued, and judgment granted to the plaintiff. Thereafter, defendant sought leave to withdraw the original answer and instanter to amend his answer to expressly deny the citizenship accredited him, and moved to dismiss upon that ground for want of jurisdiction. The motion to withdraw the answer and to answer *de novo,* and the motion to dismiss for want of jurisdiction were denied by the district judge.

The situation presented in *Page's* case is therefore parallel with ours except that the subject matter there

embraced diversity and in our case it embraces insolvency and alleged acts of bankruptcy consisting of preferential transfers while insolvent.

In *Page's* case, too, the defendant claimed the court could proceed no further without first ascertaining its jurisdiction, whereas the plaintiff claimed the court had no duty to go behind a record which disclosed jurisdiction by averment.

After a painstaking review of the authorities and quoting in part from *McNutt's* case (*supra*), that "The trial court is not bound by the pleadings of the parties," and after stating that "Defendant's answer amounted to nothing more than consent on his part that jurisdiction be taken", the Court of Appeals in *Page's* case then declared:

> "In Mitchell v. Maurer, 293 U. S. 237, 244, 55 S. Ct. 162, 165, 79 L. Ed. 338, the Court said: '* * * unlike an objection to venue, lack of federal jurisdiction cannot be waived or be overcome by an agreement of the parties. An appellate Federal Court must satisfy itself not only of its own jurisdiction, but also of that of the lower courts in a cause under review * * *'" (Id., at 452).
>
> * * *
>
> "* * * From the authorities referred to, the conclusion seems inescapable that the duty devolves upon the court 'at any time' the jurisdictional question is presented to proceed no further until that question is determined. *It cannot be conferred by agreement, consent or collusion of the parties whether contained in their pleadings or otherwise, and a party cannot be precluded from raising the question by any form of laches, waiver or estoppel.*

> So, in the instant case, if the parties jointly or singly had consented or agreed to jurisdiction, it would have been of no avail in face of the fact that the question was forcibly and directly called to the attention of the court. *The answer of the defendant conceding jurisdiction amounted to no more than consent, and, as seen, jurisdiction cannot be thus conferred irrespective of whether the consent was the result of an honest mistake or otherwise* * * *" (Id. at 453). (Italics added.)

There can be no doubt that the question was "forcibly and directly called to the attention of the court" in our case, by Mr. Waters[8] (Tr. Ap. 15, 16), Mr. Zucker[9] (Tr. Ap. 3, 4, 6), and Mr. Reid's petition, paragraph 8 (Ap. 29) to the effect that the issue was jurisdictional, that its resolution was a condition precedent to the administration of the debtors estate and that the petition must otherwise be dismissed.

The acts of bankruptcy (in our case preferential transfers while insolvent) must exist in fact, as distinguished from their mere averment in the petition; they are the

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[8] The Court: In view of the fact that you consented to reorganization and joined in the petition, how can you assert the materiality of the allegations as to solvency or acts of bankruptcy?

Mr. Waters: It is not competent for me or the debtor or anyone to relieve your Honor, the Court, or anyone of the statutory obligations of Section 143 if a material allegation of the petition is controverted.

The Court: * * * I am getting into the question of how insolvency is material.

Mr. Waters: It is jurisdictional. It is a necessary—

The Court: You are joining in the petition. In view of the fact that the debtor has joined in the petition, why is it jurisdictional?

Mr. Waters: * * * The Statute declares it to be jurisdictional.

[9] Mr. Zucker: If the debtor is solvent and there have been no acts of bankruptcy, there may not be a reorganization and the Court must dismiss the petition.

facts constituting the "subject matter" of which the court is given jurisdiction by Section 131. A consent to reorganization in the absence of the jurisdictional *res* confers no authority on the court to act in the matter, whatever may be the desires, conduct or agreement of the parties. If these jurisdictional facts do not exist (and they are denied to exist by the debtor), the judicial power of the United States simply does not extend to this reorganization proceeding.

> "The true question is not what either of the parties may be allowed to do, but whether this court will affirm or reverse a judgment of the circuit court on the merits, when it appears on the record, by a plea to the jurisdiction, that it is a case to which the judicial power of the United States does not extend. The course of the court is, when no motion is made by either party, on its own motion, to reverse such a judgment for want of jurisdiction, not only in cases where it is shown, negatively, by a plea to the jurisdiction, that jurisdiction does not exist, but even when it does not appear, affirmatively, that it does exist. *Piquignot* v. *R. R. Co.*, 16 How. 104. It acts upon the principle that the judicial power of the United States must not be exerted in a case to which it does not extend, *even if both parties desire to have it exerted. Cutler* v. *Rae*, 7 How. 729. I consider, therefore, that when there was a plea to the jurisdiction of the circuit court in a case brought here by a writ of error, the first duty of this court is, *sua sponte*, if not moved to it by either party, to examine the sufficiency of that plea, and thus to take care that neither the circuit nor this Court shall use the judicial power of the United States in a case to which the constitution and laws of the United States

> have not extended that power." (*Mansfield, Goldwater & Lake Michigan Ry.* v. *Swan*, 111 U. S. 379, 384.) (Italics ours.)[10]

The debtor's challenge to jurisdiction over the subject matter has been presented, preserved and argued from the onset of this proceeding. Indeed, the debtor's reply brief in the Court of Appeals was prefixed with the endorsement: "The question of Federal jurisdiction is additionally briefed at the request of the court."

Although the *Page, McNutt* and *Mansfield* cases received extensive consideration in appellant's reply brief, they were nowhere referred to in the opinion of the Court of Appeals.

The rationale of the decision below cannot be reconciled with the position taken by the Seventh Circuit in *Page*, with the insistence of the Supreme Court in *McNutt* that proof must be taken of controverted jurisdictional allegations, or with the "inflexible" rule of *Mansfield* v. *Swan* that an Appellate Court must dismiss where federal jurisdiction does not affirmatively appear in the record.

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[10] The enjoinder in the *Mansfield* case that judicial power shall not extend "even if both parties desire to have it exerted" is not an isolated expression. (*Toland* v. *Sprague*, 12 Pet. 300, 330; *Morris* v. *Gilmer*, 129 U. S. 315, 326; *Schell* v. *Food Machinery Corp.*, 5 Cir. 87 F. 2d 385, 387; *Kelly* v. *United States*, D. C., 59 F. 2d 743, 744).

II. The construction of §131 and §149 by the Courts below presents a question of federal law which has not been but should be settled by the Supreme Court.

Section 131

The Court below said:

> "• • • we do not hold that the debtor's answer becomes a voluntary petition, but merely that the filing of such an answer makes it unnecessary for the petitioner to allege and prove any of the acts required by §131, 11 U. S. C. A. §531." (App. A, p. 37, *infra.*)

This presents an anomaly in the federal law. Under this statute the Congress has said that petitioning creditors *must* allege certain jurisdictional facts. The Court of Appeals says they *need not* allege those facts. In consequence of that holding, this is the first and only case (there being no known recorded precedent) where a debtor has been brought into a federal court for involuntary reorganization under a creditors' petition without the showing[11] of jurisdictional facts commanded by §131.

But it is not competent for any court by a ruling nor for the debtor by any act or pleading on its part to render "unnecessary" that which the statute says is indispensable, namely, an "act of bankruptcy" under §131.

Reorganization is permitted only when the express conditions of the Bankruptcy Act are met, even though it may

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[11] Mere averment is not enough (Cf. *McNutt* v. *General Motors, supra*).

be desirable at other times. (Section 3c, d.) The Act itself prohibits any deviation from the procedure it sets forth and it is the court's responsibility to uphold the integrity of the Act and give effect to the legislative intent.

> "• • • effect must be given to the well established rule that federal jurisdiction is not to be extended beyond the scope permitted by a *strict* construction of the statute upon which it rests" (*Kresberg* v. *International Paper Co.*, 149 F. 2d 911, 913 (2nd Cir., 1945), cert. denied 66 S. Ct. 146, 90 L. Ed. 460). (Italics ours.)

Apart from the consent the court must still be *"satisfied"* that "the petition was filed in good faith and complies with the requirements of the chapter" (§§142, 143). This means that it would be insufficient to merely aver and thus fulfill the statute's requirements since the good faith requirement demands it be accurate and truthful. If the judge had reason to doubt the veracity of the allegations of the petition, as he necessarily must have had in the face of specific denials, he must, unless he dismissed the petition, seek to establish its veracity. This he could do only by taking proof, at least by a summary hearing (*Duggan* v. *Sansberry*, 327 U. S. 499, 506-507).

Under §130, a *debtor* may petition for a voluntary reorganization upon a mere showing of insolvency, or that it is unable to pay its debts as they mature. But the statutory scheme contemplates that *creditors* must show, *additionally*, an act of bankruptcy (§131). If the decision of the Court of Appeals is permitted to stand so that under its authority creditors may hereafter bring about an involuntary reorganization without establishing these addi-

tional jurisdictional facts, the statutory scheme must break down with resulting confusion in the administration of corporate reorganization under the Bankruptcy Act.

Section 149

The court below said (App. A, p. 39, *infra*):

> "* * * §149 of Chapter X, 11 U. S. C. A. §549, made the Court's order of December 14 approving the petition conclusive against the debtor. Section 149 provides: 'an order, which has become final, approving a petition filed under this chapter shall be a conclusive adjudication of the jurisdiction of the court'."

§149 does not foreclose an inquiry into federal jurisdiction. Nothing forecloses such an inquiry *in the proceeding.* §149 applies to the jurisdiction of United States district courts as conferred by §23, of "controversies at law and in equity, as distinguished from proceedings under this Act". In the proceeding itself, jurisdiction may be attacked, not only after final approval of the petition, but at *any time,* even after final judgment (*Morris* v. *Gilmer,* 129 U. S. 315, 32 L. Ed. at 693). Otherwise the constitutional and statutory limitation upon the jurisdiction of a federal court may be by-passed with a stroke of the judge's pen making his own jurisdiction "conclusive" under §149.

> "An erroneous affirmative conclusion as to the jurisdiction does not in any proper sense enlarge the jurisdiction of the court until passed upon by the court of last resort, and even then the jurisdiction becomes enlarged only from the necessity of having a judicial determination of the jurisdiction over

the subject matter" (*Stoll* v. *Gottlieb*, 305 U. S. 165, 171).

An order approving a petition necessarily presupposes the power of the judge to make the order. But the court below has now construed §149 so as to preclude a challenge to that power. This concept is opposed to the settled rule that "any time" the question of federal jurisdiction appears, all proceedings must stop until the question is determined.

This conflict in basic concepts should be resolved by the court of last resort.

III. The construction of Rule 15(a) F. R. C. P. regarding the amendment of pleadings presents a question of federal law which has not been but should be settled by the Supreme Court.

The debtor served a timely amended answer, within 20 days after service of its original answer. The Courts below said the amended answer is a nullity because it was served without leave of the Court after an order of approval was entered on the original answer. The opinion below in that regard states (App. A, p. 38, *infra*):

> "Such an amended answer, filed without leave of the court after Judge Walsh's order of December 14 which was based on the debtor's original answer of December 8, was a nullity. We assume that Rule 15, F. R. C. P. is applicable under Chapter X. That Rule provides that 'if * * * the action has not been placed upon the trial calendar,' a party may amend his pleading as a matter of course 'at any time within twenty days after it is served.' But that

> Rule cannot be construed as permitting amendment without leave of court after the court has determined the issues to which the pleadings are directed.[12] Especially must this be so in view of the ten day time limit for filing the answer under 11 U. S. C. A. §536 and the need for expedition in reorganization proceedings."

Since Rule 15 (a) F. R. C. P. applies, the debtor's right to serve an amended pleading "as a matter of course" would appear to be absolute. In such event the debtor could not be deprived of that right by the court, either by an approval of the petition or otherwise. This proposition seems to be in accord with settled authority.

> "The right to amend, as of course, is distinct from the right to amend by leave of court. It is a right which is conferred upon the parties equally with that of pleading originally, and of which a party cannot be deprived by the court. 41 Am. Jur. p. 489, §289" (*Johnson* v. *Walsh* (D. C. Mo., 1946), 65 F. Supp. 157, 160).

It has been held that under Rule 15 (a) "the right of a party to amend his pleading once as a matter of course is a procedural right which may not be denied" (*Park-in-Theatres, Inc.* v. *Paramount Richards Theatres* (D. C. Del. 1949), 9 F. R. D. 267).

The decision here is in conflict with a prior decision of the Court of Appeals for the Second Circuit, on the same matter, namely:

> "* * * it wrongfully prevented the new board from filing an amended answer within the time—*twenty*

[12] No issues raised by the debtor's answer were ever determined.

> *days* after February 23rd—*allowed them under Rule 15(a), 28 U. S. C. A. following section 723c.* That answer would have withdrawn the debtor's consent to an approval of the petition and would have put in issue the act of bankruptcy along with all the other allegations of the petition." (Judge Learned Hand in *Linahan* v. *Moore*, 117 F. 2d 140, 141-2.) (Italics added.)

The district judge entered his order approving the creditors' petition 6 days after the debtor filed its answer. If by that act he deprived the debtor of the opportunity to amend its answer within 20 days as a matter of absolute right, then the provision of Rule 15(a) that a party may amend his pleadings once "as a matter of course" is meaningless and Rule 15(a) is a nullity. The Court will then have assumed the legislative function.

This presents an important question of federal law which has not been but ought to be settled by the Supreme Court.

CONCLUSION

There is not and there never was a basis for federal jurisdiction in the court of first instance. Federal jurisdiction does not affirmatively appear in the record.

The question of federal jurisdiction was raised at the outset by the denials. The denials *always* stand as the "suggestion * * * that the court lacks jurisdiction of the subject matter" regardless of the effect which may be given to the consent, and that "suggestion" forbids the court to proceed further until the jurisdictional facts are

proved and requires dismissal on failure of proof [Rule 12(h), F. R. C. P.]. Far from charging bad faith and stifling an inquiry, the Courts below were duty bound to make one, *sua sponte* if the debtor did not come forward. Since the existence of jurisdictional facts was never established, the proceedings below are *coram non judice*. So, indeed, are the orders and judgment below.

The petition for a writ of certiorari should therefore be granted.

Dated: April 30, 1956.

Respectfully submitted,

JULIUS HALLHEIMER

LOUIS A. VALENTE

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APPENDIX A

Opinion Below

The debtor in a Chapter X reorganization appeals from orders of the District Court denying permission to employ engineers to value the assets of the debtor and denying the debtor permission to file an answer *de novo*. Affirmed.

OTIS MARK WATERS (Valente & Hallheimer, New York City, Julius Hallheimer, Louis A. Valente, of counsel on the brief) *for appellant.*

WILLIAM W. GOLUB (McGoldrick, Dannet, Horowitz & Golub, New York City, Myron S. Isaacs, Jerome Talbert, of counsel on the brief) *for the Trustee of the debtor.*

EDWARD M. GARLOCK (House, Grossman, Vorhaus & Hemley, New York City, Leonard Hemley, of counsel on the brief) *for appellees.*

WILLIAM H. TIMBERS, General Counsel, DAVID FERBER, Special Counsel and FREDERICK T. FINNIGAN, Attorney, Securities & Exchange Commission, Washington, D. C.

LUMBARD, Circuit Judge:

Since December 14, 1954 the Hudson & Manhattan Railroad Company, which owns and maintains the Hudson Tubes, an electric railway running for 14 miles from Newark, New Jersey to lower and mid-town Manhattan, has been operated by a trustee appointed by the District Court in a Chapter X bankruptcy proceeding. This debtor now

complains of orders 28 and 36, signed by Judge Walsh on February 23 and April 7, 1955 respectively. Order 28 denied the debtor authority to employ an engineering firm to value the debtor's property as of August 11, 1954, when three creditors filed an involuntary petition for a Chapter X bankruptcy proceeding. Order 36 denied the debtor's petition for leave to withdraw an "amended answer" and "consent to reorganization" which it had served and to file an "answer de novo" to the creditors' petition in place of its original answer of December 8, 1954.

Judge Walsh's orders were proper in all respects. As to Order 28, the debtor had long since been foreclosed from contesting the issue of insolvency by its answer of December 8, 1954, wherein it stated its inability to meet its debts as they matured, did not deny its insolvency, and consented to and prayed for its reorganization under Chapter X; 11 U. S. C. A. §§501 to 676. As to Order 36, it was well within the judge's discretion not to permit the debtor to change its position of consent, taken deliberately and with full knowledge of the consequences, when it made no showing of any good reason for such change. A brief recital of events preceding Orders 28 and 36 fully supports the judge's actions:

After three bondholders had, on August 11, 1954, filed a creditors' petition for a Chapter X reorganization, the debtor moved to dismiss on the ground that Chapter X did not apply as the debtor was part of a general railroad system. While this motion was awaiting decision the debtor on November 19, 1954 filed a voluntary petition alleging that it was unable to meet its debts as they matured and

asking reorganization as a railroad under Chapter VIII, 11 U. S. C. A. §205(m). This petition was referred to Judge Walsh who, on December 1, 1954 in a well considered opinion reported at 126 F. Supp. 359, denied the motion to dismiss the Chapter X proceeding and dismissed the debtor's petition for a Chapter VIII reorganization on the ground that Hudson & Manhattan was an interurban electric railway not operated as part of a general railroad system and thus was not eligible for Chapter VIII treatment. It is doubtful that this determination is now subject to review inasmuch as no appeal was taken either from the dismissal of the debtor's petition or from the denial of the motion to dismiss the Chapter X petition. *Stoll* v. *Gottlieb*, 305 U. S. 165 (1938). In any event Judge Walsh's determination is well supported by the facts and the law.

The debtor's Board of Directors at a meeting on December 2 voted not to appeal Judge Walsh's decision. On the following day William Reid, president of the debtor and chairman of its Board of Directors, announced publicly that the Board had decided to file such papers as were necessary to permit reorganization to proceed immediately under Chapter X; he pointed out that this made "unnecessary any further litigation regarding the applicable section of the Bankruptcy Act." Thus the debtor took no appeal.

Thereafter debtor's counsel advised the directors to deny any acts of bankruptcy lest they be held personally liable under the New York Stock Corporation Law for any preferential transfers made when the debtor was insolvent. Thus the debtor's answer filed on December 8, already referred to above, denied any act of bankruptcy and denied

that certain payments set forth in the petition had been preferential and had been made with intent to prefer any unsecured creditor. However, the debtor "without conceding the applicability of Chapter X" admitted that it was unable to meet its debts as they matured, consented to the reorganization and joined in so much of the petition as prayed for reorganization. The answer did not deny the creditors' allegation that the debtor was insolvent.

Section 142 of Chapter X; 11 U. S. C. A. §542 reads:

> "If an answer is not filed by a debtor to a petition against it, or if the answer filed does not controvert any material allegation of the petition, the judge shall enter an order approving the petition if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied."

The answer filed by the debtor on December 8 empowered the court under this section to approve the petition without a hearing and to appoint a trustee. The debtor's consent to reorganization and admission of inability to pay debts made the controverted allegations relating to acts of bankrutcy immaterial. In *Moore* v. *Linahan*, 117 F. 2d 140 (2 Cir. 1941), cert. denied 314 U. S. 628, we held that under Chapter X the debtor's answer, even though it requests reorganization and admits the allegations of the petition, cannot itself become a voluntary petition. We pointed out there, however, that the requirement in §131, 11 U. S. C. A. §531, that an act of bankruptcy be alleged in an involuntary petition was for the protection of the debtor. We suggested that a creditor or shareholder should not be permitted to

controvert the allegation of an act of bankruptcy if the debtor consents to reorganization and does not choose to avail itself of such a defense. But see 6 Collier on Bankruptcy 1631-32. For the same reason, if the debtor consents to reorganization it may not at the same time raise an issue as to the existence of an act of bankruptcy. The only purpose of raising such an issue is to protect the debtor from an unnecessary reorganization. If it does not desire that protection, it cannot impose upon the court the necessity of a hearing on the issue. Judge Walsh was correct in his view that the debtor's answer rendered immaterial any issues relating to insolvency or acts of bankruptcy. Cf. *In re Palisades-on-the-Desplaines,* 89 F. 2d 214, 216-17 (7 Cir. 1937); *Snyder* v. *Fenner,* 101 F. 2d 736 (3 Cir. 1939). This conclusion is not inconsistent with *Moore* v. *Linahan, supra,* for we do not hold that the debtor's answer becomes a voluntary petition, but merely that the filing of such an answer makes it unnecessary for the petitioner to allege or prove any of the acts required by §131, 11 U. S. C. A. §531.

This result finds further support in the fact that the debtor's answer constituted a written admission of inability to pay its debts and willingness to be adjudged a bankrupt. This would itself constitute an act of bankruptcy under §3a(6) of the Bankruptcy Act, 11 U. S. C. A. §21a(6). *In re Waxaid Co.,* 55 F. Supp. 289, 291 (D. C. D. Md. 1943). Thus even if the petitioning creditors were required to prove an act of bankruptcy and failed to do so, they could immediately file a new petition alleging the debtor's answer as an act of bankruptcy.

Judge Walsh was therefore correct in treating the pleadings as if the answer had not controverted any material allegation of the petition and finding that the petition "by reason of the Debtor's answer and consent to reorganization" complied with the requirements of Chapter X. He approved the petition and in the same order on December 14 appointed Herman T. Stichman as trustee. Eight days later, on December 22, and within the time permitted by 11 U. S. C. A. §537, stockholder Kyriacos Dimitriou filed an answer which denied the debtor's insolvency, the commission of any acts of bankruptcy, and inability to meet debts as they matured.

Thereafter on December 27 the debtor served what it called an "amended answer" in which, for the first time, it specifically denied that it was insolvent. The debtor again set forth its inability to meet its debts and its consent to reorganization. Such an amended answer, filed without leave of the court after Judge Walsh's order of December 14 which was based on the debtor's original answer of December 8, was a nullity. We assume that Rule 15, F. R. C. P. is applicable under Chapter X. That Rule provides that "if * * * the action has not been placed upon the trial calendar," a party may amend his pleading as a matter of course "at any time within twenty days after it is served." But that Rule cannot be construed as permitting amendment without leave of court after the court has determined the issues to which the pleadings are directed. Especially must this be so in view of the ten day time limit for filing the answer under 11 U. S. C. A. §536 and the need for expedition in reorganization proceedings. But

even if the amendment was timely it would not alter the result since the debtor reiterated its consent to reorganization and its inability to meet its debts as they matured.

On February 18, 1955 the debtor petitioned for authorization to retain an engineering firm to appraise its property. When this was heard on February 23 debtor's counsel argued that insolvency was a condition to the reorganization proceeding and that this was still to be determined. Judge Walsh denied the motion on the grounds that the debtor's answer had made insolvency immaterial and that in any event the debtor was barred from contesting the issue. In both of these conclusions he was correct. We have already pointed out that when the debtor consented to reorganization and alleged the essentials of a voluntary petition, the issues relating to acts of bankruptcy and insolvency were removed from the case. In addition §149 of Chapter X, 11 U. S. C. A. §549, made the Court's order of December 14 approving the petition conclusive against the debtor. Section 149 provides: "an order, which has become final, approving a petition filed under this chapter shall be a conclusive adjudication of the jurisdiction of the court." Of course the order of December 14 was not a final order conclusive against the shareholder who answered under §137, 11 U. S. C. A. §537. Since his answer was timely filed he cannot be barred except by a final order determining the issues raised by his answer. 6 Collier on Bankruptcy 1805-06. But the debtor may not answer under §137; its only means of contesting the petition is by answering within ten days under §136, 11 U. S. C. A. §536. Since it has answered under that section, an order has

been entered approving the petition on the basis of its answer, and the time for appealing from that order has expired, the adjudication is conclusive against the debtor. Furthermore the answer of December 8, upon which the court acted, did not even deny the petition's allegation of insolvency. It is therefore clear that Order 28 was properly entered.

The debtor's next move was to petition for leave to withdraw its "amended answer" of December 29, 1954 and to file an "answer de novo." This proposed pleading was an entire about-face from the position originally taken in the answer of December 8, 1954. It specifically denied that the debtor was insolvent; it did not consent to or join in the petition for reorganization. Counsel for the debtor now argued that it had never meant to give up the right to a trial of the issue of insolvency.

Whether to allow the debtor to change its position on these vital matters at this late date was within the discretion of the District Court. Under all the circumstances the judge would have been justified in dealing summarily with such an about-face for which no good reason was given. As it was, having, at the debtor's request, granted an order to show cause returnable in two days, Judge Walsh heard the matter fully on March 3 and 4 and granted a further adjournment over the week-end to Monday, March 7 at which time the debtor rested without calling any additional witnesses. The debtor's brief charges that the debtor was forced to trial on its petition without any opportunity to obtain and prepare witnesses, assemble evidence, bring documents into court and otherwise prepare. These charges are utterly baseless and ought not to have been made.

Appendix A

William Reid, president of the debtor, was the only witness at the hearing. It appeared from his testimony that the purpose of the proposed new answer was to preserve for junior security holders (such as Dimitriou) the right to assert the debtor's solvency in order to participate in the reorganization, to preserve for the directors' benefit the right to deny preferential acts (which had already been asserted in the December 8 answer), and to dismiss the Chapter X proceeding because the directors thought that under the Interstate Commerce Commission in a Chapter VIII proceeding they would be better able to serve their own interests than under the Securities & Exchange Commission in the present Chapter X reorganization. Reid's testimony and the maneuvers of the debtor lend considerable color to the suggestion advanced in the brief for the Trustee that the change of heart on the part of the debtor and Reid followed the appointment of a trustee other than Reid on December 14, 1954.

There was no error in excluding Reid's testimony as to the debtor's intent in seeking leave to answer de novo. A pleading speaks for itself; its intent is to be discovered from what it discloses on its face. *Dworsky* v. *Alanjay Bias Binding Corp.*, 182 F. 2d 803 (2 Cir. 1950). In any event the District Court should be allowed considerable leeway in the procedure it adopts in hearings on matters addressed to its discretion; the court was not required to permit the calling of witnesses. As it was there was considerable evidence bearing upon intent—some of which we have summarized above—and it cannot be said that the debtor was in any way prejudiced by the court's rulings.

Appendix A

In view of the expedition required in Chapter X proceedings and the necessity for the trustee to move forward with the urgent business of administration, particularly in the case of an important public utility such as the debtor here, there was added reason for Judge Walsh to deny the petition to file a new answer brought almost three months after the original answer had set in motion the Chapter X reorganization.

While it was not necessary that there be any finding as to the good faith of the debtor when it sought leave to file a new answer in place of the old, good faith was certainly relevant to the inquiry. The absence or presence of good faith bears upon whether one who petitions to file a new and different pleading, under such circumstances as are here attendant, has a good reason to ask the exercise of the court's discretion. *Kuris* v. *Pepper Poultry Co., Inc.*, 2 F. R. D. 361 (D. C. S. D. N. Y. 1941); see 3 *Moore's Federal Practice* 834. On this record there is ample support for Judge Walsh's finding that the petition was not filed in good faith and that it was without merit.

The orders appealed from are affirmed.

APPENDIX B

Judgment Below

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 9th day of February one thousand nine hundred and fifty-six.

Present:

HON. JEROME N. FRANK
HON. CARROLL C. HINCKS
HON. J. EDWARD LUMBARD
Circuit Judges

In the Matter

of

HUDSON AND MANHATTAN RAILROAD COMPANY,

Debtor-Appellant,

WILLIAM J. HARDING, JR., et al.,

Petitioning Creditors-Appellees.

Appeal from the United States District Court for the Southern District of New York.

Appendix B

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the orders of said District Court be and they are hereby affirmed; with costs taxed in favor of the Trustee.

A. DANIEL FUSARO
Clerk

APPENDIX C

Statutes and Regulations Involved

Bankruptcy Act

§24. Jurisdiction of Appellate Courts.

• • •

c. The Supreme Court of the United States is hereby vested with jurisdiction to review judgments, decrees, and orders of the United States courts of appeals in proceedings under this Act in accordance with the provisions of the laws of the United States now in force or such as may hereafter be enacted.

§30. Rules, Forms and Orders. All necessary rules, forms, and orders as to procedure and for carrying the provisions of this title into force and effect shall be prescribed, and may be amended from time to time, by the Supreme Court of the United States.

Sec. 130. Every petition shall state—

(1) that the corporation is insolvent or unable to pay its debts as they mature;

(2) the applicable jurisdictional facts requisite under this chapter;

• • •

Sec. 131. A creditors' or indenture trustee's petition shall, in addition to the allegation required by section 130 of this Act, state—

(1) that the corporation was adjudged a bankrupt in a pending proceeding in bankruptcy; or

(2) that a receiver or trustee has been appointed for or has taken charge of all or the greater portion of the property of the corporation in a pending equity proceeding; or

(3) that an indenture trustee or a mortgagee under a mortgage is, by reason of a default, in possession of all or the greater portion of the property of the corporation; or

(4) that a proceeding to foreclose a mortgage or to enforce a lien against all or the greater portion of the property of the corporation is pending; or

(5) that the corporation has committed an act of bankruptcy within four months prior to the filing of the petition.

Sec. 136. Within ten days after the service of the subpoena and of a copy of the petition, or within such further time as the court may for cause shown allow, an answer controverting the facts alleged in the petition may be filed by the debtor.

Sec. 142. If an answer is not filed by a debtor to a petition against it, or if the answer filed does not controvert any material allegations of the petition, the judge shall enter an order approving the petition if satisfied that it com-

plies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Section 143. If the answer of a debtor shall controvert any of the material allegations of the petition, the judge shall as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied.

Sec. 149. An order, which has become final, approving a petition filed under this chapter shall be a conclusive determination of the jurisdiction of the court.

Rules of Civil Procedure for the United States District Courts

Rule 12. Defenses and Objections—When and How Presented—By Pleading or Motion—Motion for Judgment on the Pleadings.

(h) Waiver of Defenses

* * * (2) * * * whenever it appears by suggestion of the parties or otherwise that the Court lacks jurisdiction of the subject matter, the Court shall dismiss the action.

Rule 15. Amended and Supplemental Pleadings.

(a) Amendments. A party may amend his pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleadings is permitted and the action has not been placed upon the trial calendar, he may so amend it at any time within 20 days after it is served. Otherwise a party may amend his pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires. A party shall plead in response to an amended pleading within the time remaining for response to the original pleading or within 10 days after service of the amended pleading, whichever period may be the longer, unless the court otherwise orders.

General Orders in Bankruptcy

37. General Provisions

In proceedings under the Act the Rules of Civil Procedure for the District Court of the United States shall, in so far as they are not inconsistent with the Act or with these general orders, be followed as nearly as may be. But the court may shorten the limitations of time prescribed so as to expedite hearings, and may otherwise modify the rules for the preparation or hearing of any particular proceeding.

No. 924

MAY 31 1956
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

HUDSON & MANHATTAN RAILROAD COMPANY,
DEBTOR,
Petitioner,

v.

HERMAN T. STICHMAN, TRUSTEE OF THE DEBTOR,

WILLIAM J. HARDING, JR., IRVING I. SCHNUR AND SHIRLEY REITER, PETITIONING CREDITORS,

AND

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR HERMAN T. STICHMAN, TRUSTEE OF THE DEBTOR, IN OPPOSITION

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BRIEF FOR HERMAN T. STICHMAN, TRUSTEE OF THE DEBTOR, IN OPPOSITION

Opinions Below

The opinion of the Court of Appeals (Appendix A of the petition), reported in 229 F. 2d 616, affirms two interlocutory orders of the United States District Court for the Southern District of New York, Order No. 28 and Order No. 36. The District Court did not enter an opinion with

respect to Order No. 28; its oral ruling appears at Tr. App. 28.[1] The opinion of the District Court with respect to Order No. 36 was entered orally on March 7, 1955 (Tr. App. 265-6), and has not been reported.

Questions Presented

1. Whether the District Court abused its discretion in refusing to direct a Chapter X trustee to pay the charges of engineers to be employed by a debtor for the purpose of valuing the debtor's property as of the time of the filing of an involuntary Chapter X petition which had already been approved on the basis of the debtor's answer and consent to reorganization.

2. Whether the District Court abused its discretion in refusing to permit a debtor to file an answer *de novo* withdrawing its consent to and prayer for reorganization under Chapter X, months after the District Court, acting upon the debtor's original answer and consent, had approved an involuntary petition.

Statutes Involved

The pertinent provisions of the Bankruptcy Act are set forth in Appendix C of the petition and in Appendix A hereof.

Statement

Petitioner seeks review by this Court of a judgment of the United States Court of Appeals for the Second

[1] The appendix to the Trustee's brief in the Court of Appeals is referred to herein as "Tr. App.", the appendix to the Debtor-petitioner's brief below as "D. App.", and the unprinted record on appeal as "R."

Circuit which affirmed two interlocutory orders of the United States District Court for the Southern District of New York entered during the course of Chapter X proceedings for the reorganization of Hudson & Manhattan Railroad Company, Debtor. Both orders related to petitions filed by the Debtor months after the District Court had approved an involuntary petition under Chapter X on the basis of the Debtor's answer and consent to reorganization.

Order No. 28, entered February 23, 1955 (D. App. 3), denied the Debtor's petition (D. App. 27-35) for an order authorizing it to employ a firm of engineers, at the expense of the estate, to value the Debtor's property as of the date of the filing of the involuntary petition which instituted the proceeding.

Order No. 36, entered April 7, 1955 (D. App. 4-8), denied the Debtor's petition (D. App. 37-44) to withdraw its "amended answer" to the involuntary petition and to file an answer *de novo* withdrawing the consent to and prayer for reorganization under Chapter X contained in both the Debtor's original answer (D. App. 18-19) and its "amended answer" (D. App. 23-4).

On August 11, 1954, three bondholders of the Debtor filed an involuntary petition for a Chapter X reorganization (D. App. 9-16; Tr. App. 280-90). The Debtor moved on extensive affidavits to dismiss on the ground that Chapter X did not apply, asserting that the Debtor was part of the Pennsylvania Railroad's general railroad system and thus was a "railroad corporation" whose reorganization would be governed by Section 77 of the Bankruptcy Act and not Chapter X (R. 730A-CC).

On November 19, 1954, while its motion to dismiss was awaiting decision, the Debtor filed a voluntary petition in a separate proceeding, alleging that it was unable to

meet its debts as they matured and seeking reorganization under Section 77 (D. Ex. 2; R. 723E-H; Tr. App. 161-4).

On November 24, 1954, the District Court appointed a receiver for the Debtor, on motion of the petitioning creditors (R. 723K, 724-8). The Debtor immediately appealed from this order (R. 729).

On December 1, 1954, the District Court entered its opinion and orders denying the Debtor's motion to dismiss the Chapter X proceeding and dismissing the Debtor's petition for a Section 77 reorganization upon the finding that the Debtor was an interurban electric railway not operated as part of a general railroad system, and thus was subject to reorganization under Chapter X and not under Section 77. *In re Hudson & Manhattan R. Co.*, 126 F. Supp. 359. No appeal was taken either from the dismissal of the Debtor's Section 77 petition, or from the denial of its motion to dismiss the Chapter X petition.

The Debtor's decision not to appeal the December 1 orders of the District Court was based on a thorough canvass of the situation by its board of directors on the following day. Upon recommendation of the president of the Debtor, and over the opposition of counsel, the board adopted a resolution instructing counsel to withdraw the appeal from the order appointing a receiver and to file such papers as might be necessary to permit the reorganization of the Debtor under Chapter X (Tr. App. 83-6, 165-9, 238-9, 291-4). The resolution was followed by a public announcement which stated that the action of the board made unnecessary any further litigation regarding the applicable section of the Bankruptcy Act, and that it was expected to lead to the appointment of a trustee within the next few days (Tr. App. 295).

The Debtor's counsel advised the directors on December 6, 1954 that, to protect the directors from personal liability

under the New York Stock Corporation Law, the acts of bankruptcy alleged in the petition should be denied (D. App. 109-10). Counsel were instructed the same day to file a formal answer denying the acts of bankruptcy but joining in the prayer of the petition for reorganization (D. App. 112).

On December 8, 1954, the Debtor's answer and consent to reorganization was served and filed in the Chapter X proceeding. In this pleading, the Debtor, without conceding the applicability of Chapter X, admitted that it was unable to meet its debts as they matured, denied the alleged acts of bankruptcy, consented to its reorganization, and joined in so much of the petition as prayed for reorganization (D. App. 19).

On December 14, 1954, the District Court entered Order No. 10 approving the creditors' petition "due to and by reason of the Debtor's answer and consent to reorganization", and appointing Herman T. Stichman as Trustee of the Debtor (R. 748-57). The Debtor did not appeal from this order (D. App. 6).

On December 22, 1954, an individual stockholder filed an answer to the creditors' petition, denying that the Debtor was insolvent or unable to pay its debts as they mature, but admitting, by failure to deny, the allegations of the petition establishing the Court's jurisdiction under Chapter X (D. App. 21-2).[2]

On December 29, 1954, the Debtor, without applying for leave of the District Court, filed what purported to be an "amended answer and consent to reorganization", served

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[2] Hearings were held on the issues raised by the stockholder's answer. On December 21, 1955, upon the conclusion of these hearings, the original approval of the creditors' petition by Order No. 10 was reaffirmed by the District Court. *In re Hudson & Manhattan R. Co.*, 138 F. Supp. 195. No appeal was taken from the order entered on this opinion, and the time to appeal has expired.

the previous day, which denied that the Debtor was insolvent and certain other allegations of the creditors' petition, in addition to denying (as in its original answer) the alleged acts of bankruptcy (D. App. 23-4). Again the Debtor specifically admitted its inability to meet its debts as they mature, consented to its reorganization, and joined in so much of the creditors' petition as prayed for reorganization.

On February 18, 1955, pursuant to a decision of the Debtor's board of directors that month to join forces with the answering stockholder (Tr. App. 198-200), the Debtor petitioned the District Court for an order authorizing it to employ engineers, at the expense of the estate, to value the Debtor's property as of August 11, 1954 and the four months prior thereto (D. App. 27-35). The petition estimated that the study would require about four months, and sought approval of the charges of the engineers up to $40,000 without further order of the Court.

Thus, for the first time since the determination of the board on December 2, 1954 to proceed promptly with reorganization under Chapter X, the Debtor asserted that the District Court's determination of insolvency was a condition precedent to the reorganization of the Debtor (D. App. 29). The District Court ruled that the Debtor's answer had eliminated insolvency as an issue material to the Court's jurisdiction, and that the Debtor was barred from contesting the issue (Tr. App. 24, 28). It entered Order No. 28, denying the Debtor's petition.

The Debtor then sought to reverse completely the position taken in its answer and consent to reorganization. On March 1, 1955, the Debtor moved for leave to withdraw its "amended answer and consent to reorganization" and for leave to answer *de novo* (D. App. 36-7). The proposed answer *de novo* would have omitted the Debtor's consent to reorganization under Chapter X, its joinder in the prayer

for reorganization, and its specific admission that it was unable to meet its debts as they mature, but would have continued to admit its inability to pay debts by failure to deny that allegation of the creditors' petition (D. App. 43-4).

Following a full hearing of the Debtor's evidence and argument, the District Court announced its decision denying the Debtor's petition upon findings that it lacked merit and that it was not filed in good faith (Tr. App. 1-266). Following another hearing on the form of order (Tr. App. 267-79), the District Court entered Order No. 36, denying the petition on those grounds.

Argument

1. The judgment of the Court of Appeals, affirming two interlocutory orders of the District Court, does not present the questions stated in the petition. Both are orders which could properly be entered by the District Court, as a matter of discretion on the facts before the Court, however the questions stated in the petition might be determined.

Order No. 28 denied a petition of the Debtor to charge the estate with engineers' fees up to $40,000, before any services had been rendered. Even if the issue of insolvency had been material at the stage of the proceeding when the Debtor's petition was made, there nevertheless was no statutory basis for directing the Trustee to pay the charges of engineers to be employed either by creditors to prove insolvency or by the Debtor to prove solvency. The Bankruptcy Act does not contemplate that litigants will have their fees and expenses financed in advance by the estate. Compensation for services and reimbursement of expenses is allowed only after services have been rendered and their

value to the estate is known. Bankruptcy Act, §§241-243, 11 U. S. C. §§641-643.

Order No. 36 denied the Debtor's petition, addressed to the discretion of the District Court, for leave to withdraw an answer months after it had been filed and the issues adjudicated, on the ground that it was not filed in good faith as well as its lack of merit. On the record, as held by the Court of Appeals, there is ample support for the finding of lack of good faith.

The denial of neither petition thus presents any question of law appropriate for review by this Court.

2. The jurisdiction of the District Court to proceed with the reorganization of this Debtor under Chapter X of the Bankruptcy Act was determined by the District Court on December 1, 1954, not only by an order in this Chapter X proceeding, but also by an order in the separate proceeding instituted by the Debtor under Section 77. That determination of jurisdiction is *res judicata* of the issue, and is not subject to collateral attack. *Stoll* v. *Gottlieb*, 305 U. S. 165 (1938); *Baldwin* v. *Iowa State Traveling Men's Association*, 283 U. S. 522 (1931).

The District Court's Order No. 10 of December 14, 1954, approving the creditors' petition and appointing a Trustee upon the basis of the Debtor's answer and consent to reorganization, had become final before the filing of either of the Debtor's petitions denied below, and has never been appealed. Under Section 149 of the Bankruptcy Act, as well as under the cases cited above, that order constitutes a conclusive determination of the jurisdiction of the Court in so far as the Debtor is concerned. Such an order is subject to review by appeal, but not by collateral attack after the time to appeal has expired.

Moreover, as held below, the District Court determination of the Chapter X-Section 77 jurisdictional issue was well supported by the facts and the law (petition, p. 35).

3. Under Chapter X, a debtor can make unnecessary the proof of an act of bankruptcy otherwise required by Section 131 in involuntary proceedings by filing an answer which embodies the substance of a voluntary petition. Indeed, such an answer is itself an act of bankruptcy under Section 3a(6) of the Bankruptcy Act, 11 U. S. C. §21a(6). Since a debtor which desires reorganization cannot file a voluntary petition when an involuntary petition is pending (Section 126, 11 U. S. C. §526), this form of answer enables such a debtor to obtain prompt relief under Chapter X. Compare *Moore* v. *Linahan*, 117 F. 2d 140, 143 (2d Cir. 1941), cert. denied 314 U. S. 628 (1948).

4. Whether the Debtor was entitled, without leave of the Court, to amend its answer 20 days after the answer was filed and 14 days after the District Court's final determination of the issues to which the answer was directed, is not relevant to the petition herein. The Court of Appeals properly held that the "amended answer" of the Debtor was a nullity, but held further that, even had it been timely, "it would not alter the result since the debtor reiterated its consent to reorganization and its inability to meet its debts as they matured" (petition, p. 39). Clearly, the Debtor was not entitled to withdraw that consent and to file the proposed answer *de novo* months later.

5. The petitioner's assertions of conflict of the decision below with the decisions of this and other courts are frivolous. The cases cited are not decisions on the same matter, and are wholly consistent with the decision of the Court of Appeals herein.

Conclusion

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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McGOLDRICK, DANNETT,
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Of Counsel.

Dated: May 29, 1956.

Appendix A

PERTINENT PROVISIONS OF THE BANKRUPTCY ACT

Sec. 3. Acts of Bankruptcy. Acts of bankruptcy by a person shall consist of his having * * * (6) admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt.

Sec. 126. Filing petition; persons entitled. A corporation, or three or more creditors who have claims against a corporation or its property amounting in the aggregate to $5,000 or over, liquidated as to amount and not contingent as to liability, or an indenture trustee where the securities outstanding under the indenture are liquidated as to amount and not contingent as to liability, may, if no other petition by or against such corporation is pending under this chapter, file a petition under this chapter.

No. 924

JUN 4 1956
HAROLD B. WILLEY, C

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

HUDSON & MANHATTAN RAILROAD COMPANY,
DEBTOR,
Petitioner,

v.

WILLIAM J. HARDING, JR., IRVING I. SCHNUR AND SHIRLEY REITER, PETITIONING CREDITORS,

HERMAN T. STICHMAN, TRUSTEE OF THE DEBTOR,

AND

SECURITIES AND EXCHANGE COMMISSION,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONING CREDITORS-RESPONDENTS, IN OPPOSITION.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONING CREDITORS-RESPONDENTS, IN OPPOSITION.

Statement

The petitioner (the Debtor) seeks review of a judgment of the United States Court of Appeals for the Second Circuit, which affirmed two interlocutory orders made by the United States District Court for the Southern District of New York in the proceedings in that court for the involuntary organization of the Debtor under Chapter X

of the Bankruptcy Act. Each of these orders denied a motion by the Debtor, addressed to the discretion of the district court, and made long after the entry, upon its answering admissions and consent, of an order approving the involuntary petition and appointing a reorganization Trustee.

The first order (Order No. 28) denied a motion for authorization to employ engineers to make a valuation study at the expense of the trust estate. The second order (Order No. 36) denied a motion for leave to withdraw an "amended answer" filed without leave subsequent to the order of approval, and to file a proposed answer *de novo* which would convert prior admissions into denials and repudiate the Debtor's consent to reorganization under Chapter X.

The relevant facts are stated in the opinion of the Court of Appeals on affirmance, reported at 229 F. 2d 616, and in the opposing brief of the Trustee; and their repetition here would be superflous. We are content to emphasize certain of their salient aspects:

(a) The involuntary petition was filed on August 11, 1954. By obtaining successive orders extending its time to answer until September 24, 1954, and then moving to dismiss, the Debtor postponed answering until December 8, 1954. Obviously, the answer it then filed was carefully considered and seriously intended as a final pleading; and, in view of the ordinary ten day answering period prescribed by Section 136,* the long postponement of the Debtor's original answer was alone sufficient justification for denial of the motion for leave to plead *de novo*.

(b) The motion to dismiss the involuntary petition was made under Rule 12 (b)(1) of the Federal Rules of Civil

* All section references in this brief are to sections of the Bankruptcy Act.

Procedure, on the ground that the district court lacked jurisdiction of the subject matter. It was a "speaking motion", based on affidavits in support of the claim that the Debtor's interurban electric railroad is operated as a part of a general railroad system of transportation and, therefore, that the Debtor must be reorganized under Section 77. The district court decided that question of fact on affidavits, at the urgent request of the Debtor;* and, in its original answer, the Debtor admitted by silence the allegation of the involuntary petition that its interurban electric railroad is not operated as a part of a general railroad system of transportation.

(c) The Debtor's original answer contained admissions sufficient for a voluntary petition under Section 130.

(d) The Debtor withdrew its appeal from the order appointing a receiver.

(e) It did not appeal from the order denying its motion to dismiss the involuntary petition.

(f) It did not appeal from the order dismissing its petition for reorganization under Section 77.

(g) It did not appeal from the order of approval.

(h) The time to appeal from each of those orders had expired long before it made the motions which resulted in the orders now challenged.

---

* The opinion, finding that the Debtor's railroad is not operated as a part of a general railroad system of transportation, holding that the Debtor must therefore be reorganized under Chapter X, and denying the motion to dismiss, is reported at 126 F. Supp. 359.

Argument

1. The judgment of affirmance below does not present the questions stated in the petition. Each of the motions below was plainly addressed to the discretion of the district court; and neither of them was based on any substantial ground for the exercise of such discretion in favor of the Debtor.

Even if the issue of insolvency was still material when the Debtor moved for authority to employ engineers at the expense of the trust estate for the purpose of litigating that issue, there is no statutory basis for such authority; and it would have been palpable error to grant it.

The circumstances under which the Debtor suddenly moved for leave to plead *de novo*, and thus to invalidate the order of approval which the Debtor itself had prayed for, are stated in the opinion on affirmance below. They fully justify the finding of the district court that the motion was not made in good faith.

The denial of those motions does not present any question of law appropriate for review by this Court.

2. The jurisdiction of the district court to reorganize the Debtor under Chapter X was finally and conclusively established by the order denying the motion to dismiss and by the order dismissing the Debtor's petition for reorganization under Section 77. The latter order is a final adjudication of the Section 77 issue, and is not subject to collateral attack. *Stoll* v. *Gottlieb*, 305 U. S. 165.

3. The order of approval also constitutes a conclusive determination of the district court's jurisdiction, which is similarly immune from collateral attack. Section 149 of Chapter X provides as follows:

> "An order, which has become final, approving a petition under this chapter, shall be a conclusive determination of the jurisdiction of the court."

The order of approval here became final long before the Debtor made the motions denied below.

The suggestion, at p. 28 of the petition, that Section 149 relates to jurisdiction under Section 23 of Chapter IV, and not to jurisdiction under Chapter X, is preposterous. The language of Section 149 is too plan for such devious distortion; and, under Section 102, Section 23 does not apply to a Chapter X proceeding.*

4. The Debtor's original answer affirmed its inability to pay its debts as they matured; it admitted by silence the allegations of the involuntary petition respecting its insolvency and its status as a railroad corporation subject to reorganization under Chapter X; and it consented to and prayed for reorganization thereunder. The order of approval based on that answer constituted a holding, by necessary implication, that the denials of the preferential payments alleged as acts of bankruptcy did not raise a material issue. Even if the extravagant assumption is made that this implicit holding is erroneous, it is nevertheless the law of this case; and it is not subject to collateral attack or review.

5. The Debtor's arguments rest on the proposition that jurisdiction in a Chapter X proceeding can be challenged

* Senate Report 1916, 75th Cong., 3rd Sess. says (p. 27) that Section 149 "is designed to foreclose all direct or collateral attack upon jurisdiction or venue, once the period of appeal from an order approving the petition has expired". The cases similarly interpret this section. See: *In Re Barlum Realty Co.*, 62 Fed. Supp. 81, 86; *Country Life Apartments* v. *Buckley*, 145 F. 2d 935, 938; *In Re V. Loewer's Gambrinus Brewery Co.*, 141 F. 2d 747, 749; *In Re St. Charles Hotel Co.*, 157 F. 2d 317, 320, cert. den. 329 U. S. 799.

at any time and that an order of approval which has become final does not foreclose such a challenge. If this proposition were sustained, reorganization under Chapter X would not be practicable.

6. An involuntary petition under Chapter X must allege an act of bankruptcy. But the debtor can relieve the petitioning creditors of the burden of proving the alleged act of bankruptcy by filing an answer which embodies the substance of a voluntary petition.* Such an answer would not controvert any material allegation within the meaning of Section 142. If this were not so, the absurd result would follow of a futile trial and needless, probably dangerous and possibly fatal delay, where the debtor itself desires and urges reorganization. For such a debtor is precluded by Section 126 from filing a voluntary petition when an involuntary petition is pending. The requirement of Section 131 that an involuntary petition must allege an act of bankruptcy cannot be equated with a requirement of proof despite such an answer. Compare *Moore* v. *Linahan*, 117 F. 2d 140, 143, cert. den. 314 U. S. 628.

7. Under Sections 21k and 102, the Federal Rules of Civil Procedure are applicable to a Chapter X proceeding only to the extent that they are consistent with the provisions of Chapter X. Rule 15(a) is inconsistent with the provisions of Sections 136, 142 and 149. The "amended answer", filed without leave subsequent to the order of approval, was therefore a nullity.

8. The Debtor's contentions that the decision below is in conflict with decisions of the Court of Appeals for the Seventh Circuit and of this Court are untenable. The cases

* Indeed, such an answer is itself an act of bankruptcy under Section 3a(6).

it cites deal with an incurable absence of jurisdiction *ab initio.* Here the district court had jurisdiction of the Debtor and the subject matter, the involuntary petition was sufficient on its face, and the question (if it can be raised at all) is whether the district court lost jurisdiction because it dispensed with proof of a fact which the Debtor's answer rendered immaterial. That question must be answered in the negative.

Conclusion

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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Dated: June 2, 1956.

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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 924

HUDSON & MANHATTAN RAILROAD COMPANY,
PETITIONER

v.

WILLIAM J. HARDING, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION[1]

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. 33–42) is reported at 229 F. 2d 616. The opinion of the District Court (Tr. App. 265–266)[2] has not been reported.

[1] The Commission became a party to the proceeding in the District Court pursuant to Section 208 of the Bankruptcy Act (11 U. S. C. 608) and appeared in the Court of Appeals urging affirmance of the orders involved (see Pet. App. 33).

[2] "Tr. App." refers to the appendix to the brief in the Court of Appeals of Herman T. Stichman, trustee of the debtor and an appellee in the court below. "App." refers to the appendix to the brief below of the appellant, petitioner here.

JURISDICTION

The judgment of the Court of Appeals (Pet. App. 43–44) was entered on February 9, 1956. The petition for a writ of certiorari was filed on May 4, 1956. The jurisdiction of this Court is invoked under Section 24 (c) of the Bankruptcy Act (11 U. S. C. 47 (c)).

QUESTIONS PRESENTED

1. Whether in a reorganization under Chapter X of the Bankruptcy Act the courts below correctly refused to authorize the hiring by the debtor of engineering experts to make a valuation of the debtor's properties for the purpose of disproving allegations relating to insolvency in the creditors' petition for reorganization, where the request for this action was made subsequent to court approval of the petition, and where this approval had been given in reliance upon the debtor's answer alleging that it could not meet its debts as they matured and joining in the prayer seeking reorganization under Chapter X.

2. Whether it was proper to deny petitioner's motion for leave to file, some three months after its original answer, an "answer de novo" seeking to relitigate jurisdictional issues which had already been resolved.

STATUTE INVOLVED

The pertinent sections of Chapter X of the Bankruptcy Act, 54 Stat. 709, as amended, 11 U. S. C. 401 *et seq.*, are set forth in Appendix C

to the petition for a writ of certiorari (Pet. App. 45–47).

STATEMENT

Petitioner (sometimes referred to herein as the debtor) is a corporation which owns and operates (1) an electric inter-urban railroad carrying passengers exclusively between New York City and nearby points in New Jersey through its tunnels under the Hudson River and (2) two large office buildings in New York City. It has funded debt due February 1, 1957, of approximately $57,000,000, including deferred interest (App. 10, 11, 12). It is alleged that in each of the years 1947 through 1953 the debtor lost from approximately $947,000 to $1,722,000 (Tr. App. 282).

The orders sought to be reviewed arose during the course of a proceeding under Chapter X of the Bankruptcy Act, which was instituted on August 11, 1954, by the filing of an involuntary petition in the United States District Court for the Southern District of New York by three bondholders of the debtor. The petition alleged *inter alia* that the debtor was a railroad corporation authorized by Chapter X to file a voluntary petition for reorganization thereunder, that it was unable to meet its debts as they matured, that it was insolvent, and that it had committed acts of bankruptcy by making preferential payments (Tr. App. 9–16).

On December 8, 1954, the debtor filed an answer consenting to the reorganization and joining in

so much of the petition as prayed for the reorganization. This followed the denial of a motion the debtor had filed to dismiss the petition on the ground that the debtor was operated as part of a general railroad system and hence not authorized to obtain relief under Chapter X and the simultaneous denial of an application by the debtor for approval of a voluntary petition it had filed on November 19, 1954, seeking reorganization under Section 77 of the Bankruptcy Act (11 U. S. C. 205). The consenting answer filed on December 8, 1954, like the Section 77 petition which the debtor had filed, expressly stated that the debtor was unable to meet its debts as they matured. This answer denied the allegations as to acts of bankruptcy, but, by failure to deny them, admitted the other allegations of the creditors' petition.[2] (Tr. App. 18–19.)

On December 14, 1954, the District Court approved the Chapter X petition upon "being satisfied that the petition, by reason of the debtor's answer, and consent to reorganization, complies with the requirements of Chapter X of the Bankruptcy Act and has been filed in good faith" (Tr. App. 20). No appeal was taken from this order.

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[2] In a preamble to the answer it was stated that the applicability of Chapter X was not conceded, but there was no express denial of the allegation that the debtor was a railroad corporation authorized by Chapter X to file a petition for reorganization thereunder.

On December 28, 1954, the debtor served a purported "amended answer" to the creditors' petition, which again specifically consented to the reorganization and joined in the prayer of the petition for reorganization. This answer was substantially in the same form as the original answer, but it denied various allegations of the petition (although not the allegation respecting the capacity of the debtor to file a Chapter X petition), and it specifically denied that the debtor was insolvent as well as that preferential payments had been made. No court approval of its filing was ever sought.

In the meantime, on December 22, 1954, a stockholder, pursuant to Section 137 of the Bankruptcy Act (11 U. S. C. 537), had filed an answer to the creditors' petition, which answer raised no question with respect to the jurisdiction under Chapter X, as distinguished from Section 77, but which denied among other things that the debtor was insolvent, that it had committeed any acts of bankruptcy, and that it was unable to meet its debts as they matured (Tr. App. 21–22).[4]

[4] Section 137 permits the filing of an answer controverting the allegations of a voluntary or involuntary petition, after its initial approval by the court under Section 141 or 142, by any creditor or indenture trustee, or if the debtor is not insolvent, by any stockholder of the debtor. On December 21, 1955, the District Court determined that the answer filed by the stockholder in this case should be treated as though it had been filed after a voluntary petition by the debtor, and, therefore, that the only material issue triable, assuming that the debtor was solvent, was whether or not the debtor was un-

Thereafter, when a pre-trial hearing had bee scheduled with respect to the stockholder's an swer, the debtor moved for authorization to re tain an engineering firm to appraise its property at the expense of the estate. In this connection the debtor urged that "the d ermination of the issue of insolvency by the Court is a condition t the reorganization of the Debtor and the adminis tration of its estate in this proceeding" (Tr. App 29), and it indicated that it expected to litigate at that time the question of its solvency (Tr. App 28, 50–52). The court denied the application on February 23, 1955 (Tr. App. 3), having stated: "I am going to hold now, as a matter of law, that insolvency or solvency is not an issue material to this proceeding so far as the debtor is concerned" (Tr. App. 52). The order to this effect (Tr. App. 3) is one of the two orders affirmed by the court below as to which the debtor seeks further review. The debtor then moved to withdraw its amended answer and to file an "answer de novo" (Tr. App. 36). The proposed "answer de novo," although not denying the allegation that the debtor could not meet its debts as they matured, omitted the specific affirmative allegation to that effect, and,

able to meet its debts as they matured. On this issue, the court received proof and found that "at the time the petition was filed the debtor was unable to meet its debts as they matured and that the previous approval of the petition for reorganization should be reaffirmed." *In re Hudson & Manhattan Railroad Company*, 138 F. Supp. 195, 203 (S. D. N. Y.).

unlike the earlier answer, did not consent to or join in the petition for reorganization (Tr. App. 43–44).

A hearing on this motion was held on March 3, continued on March 4, and adjourned over the weekend to March 7, 1955, on which day the debtor rested (Tr. App. 32, 253–254). At the hearing the debtor offered the testimony of Mr. Reid, president of the debtor and chairman of its board of directors, who had verified the answers. He testified that the purposes of the new answer sought to be filed were: to preserve for the junior security holders the right to assert that the debtor was solvent in order to participate in the reorganization, to preserve for the benefit of the directors the right to deny preferential acts, and to have the Chapter X proceeding dismissed because the debtor would be better off under Section 77 and the I. C. C. than under Chapter X and the S. E. C. (Tr. App. 170, 171, 212, 215–216, 221–222).[5]

The District Court denied the debtor's motion to withdraw its amended answer and file a new answer, finding that the proposal to file a new answer was without merit and not made in good faith. The order to that effect, entered April 7,

[5] It was not made clear how jurisdiction by the I. C. C. could be obtained in view of the fact that the debtor had not appealed from the order denying its motion to dismiss the Chapter X proceeding or from the order denying its application for approval of its Section 77 petition and the time to appeal from both orders had expired.

1955 (Tr. App. 4–8), is the second order affirmed by the court below as to which the debtor seeks further review in this Court. The court below found with respect thereto that there was "ample support" for the District Court's finding that the application "was not filed in good faith and that it was without merit." (Pet. App. 42.)

ARGUMENT

The orders sought to be reviewed, while appealable, are interlocutory and of a discretionary nature. We submit that the determinations of the courts below are correct and are not in conflict with holdings of other courts of appeals or of this Court. Although petitioner has attempted to phrase its first two questions presented in jurisdictional terms (Pet. 2–3), there is no serious problem of jurisdiction involved or any other problem of sufficient importance to warrant review by this Court. The third question which the petitioner asserts is involved (Pet. 3) is based on an interpretation by the court below of a procedural rule as to which the court correctly stated that a contrary determination "would not alter the result" (Pet. App. 39).

1. Despite the fact that petitioner joined in asking the relief sought by the creditors' petition and admitted allegations therein clearly sufficient to give the court jurisdiction over a debtor's petition, petitioner now urges that the District Court has no jurisdiction over this Chapter X proceed-

ing. The gist of petitioner's complaint is that allegations of the creditors' petition, which would have been essential had the debtor not joined in its request for relief, were not proved. Petitioner's position stems from the refusal of the District Court to permit petitioner to litigate an issue respecting its solvency after approval of the involuntary Chapter X petition.[6] The creditors' petition alleged that the debtor, while insolvent, had made a preferential transfer of its property. Such a transfer is an act of bankruptcy,[7] and a creditor's petition must allege the commission of an act of bankruptcy by the debtor within the preceding four months (in the absence of certain other allegations irrelevant here) in addition to the requirements applicable to a debtor's petition. Section 130 and 131 of the Act (11 U. S. C. 530 and 531). The only allegation respecting insolvency required in a debtor's petition, on the other hand, is that the debtor be "insolvent or unable to pay its debts as they mature." Section 130 (1) of the Act (11 U. S. C. 530 (1)). As we have noted, both petitioner's original and amended answer alleged that it was unable to meet its debts as they matured, and both joined in the prayer for reorganization.

[6] This was the basis of the District Court's denial of petitioner's application to have engineers employed at the expense of the estate for the purpose of determining petitioner's insolvency, the first order of which petitioner seeks further review.

[7] See Section 3 (a) (2) of the Act (11 U. S. C. 21 (a) (2)).